

A study of retirement benefit reductions

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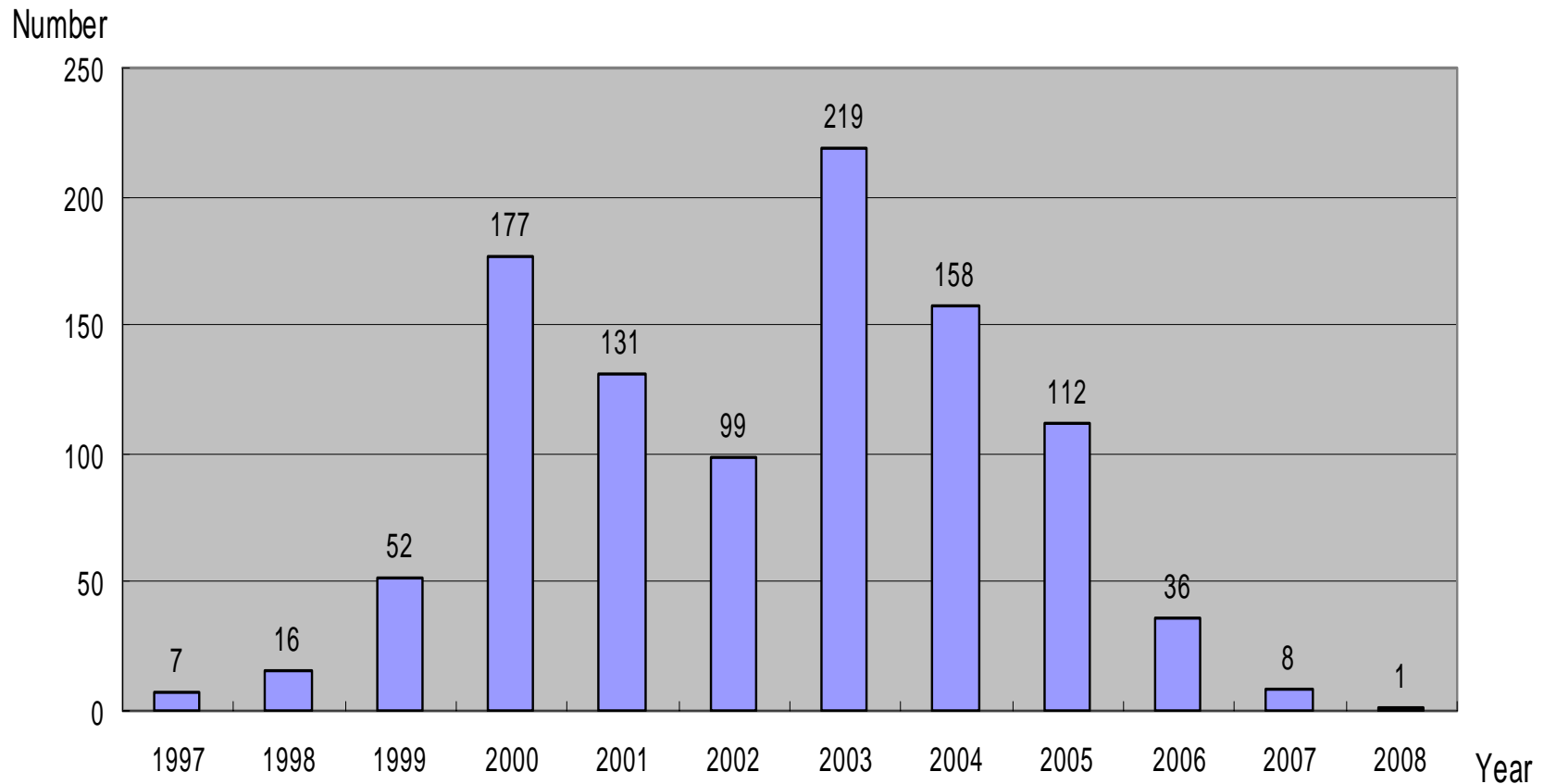


Outline of today's session

- 1 . Circumstances of corporate pension benefit reductions
- 2 . Examples of litigation over corporate pension benefit reductions
- 3 . Criteria for judgment on corporate pension benefit reductions
- 4 . Proposal for reduction criteria

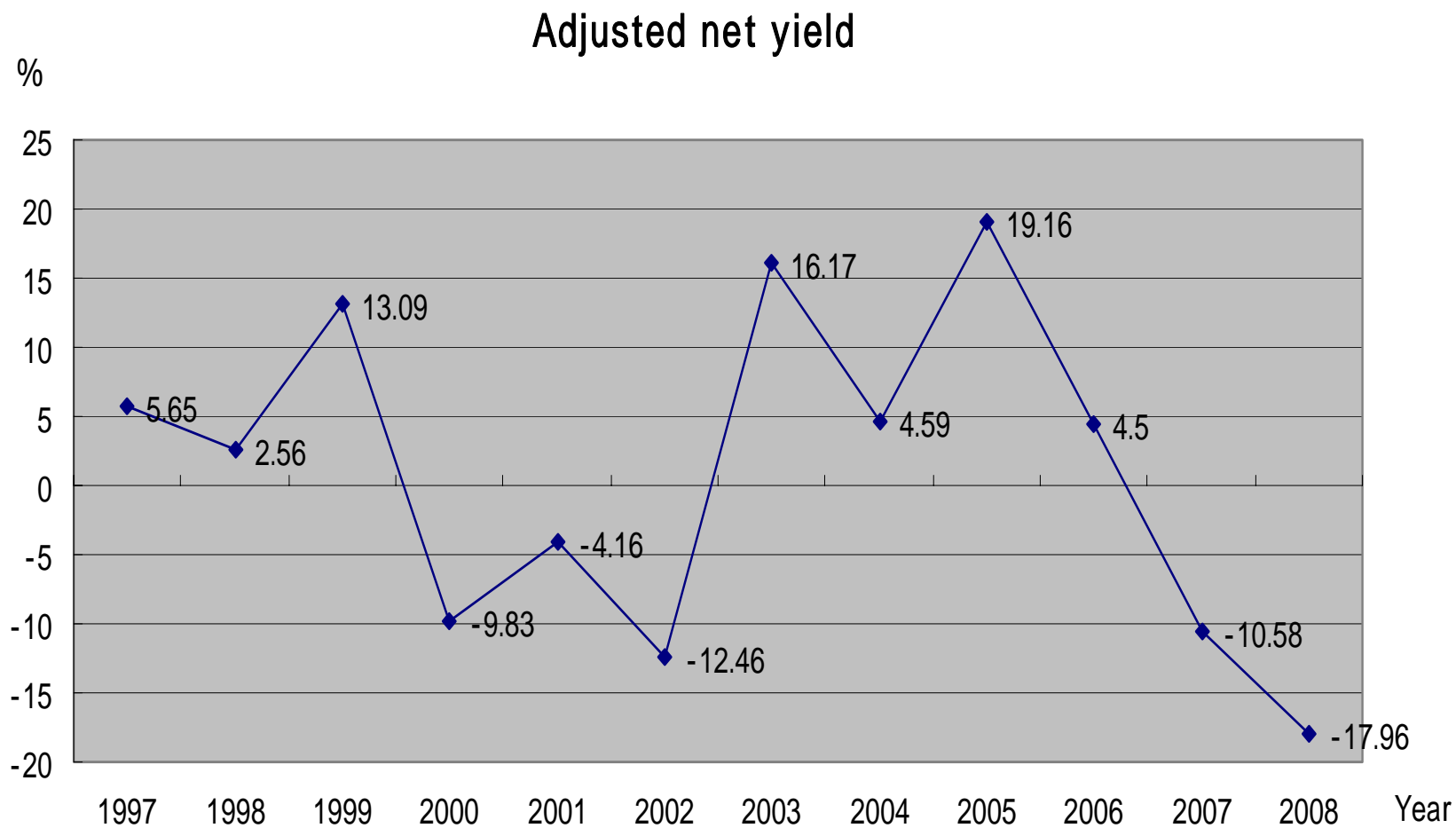
1. Circumstances of corporate pension benefit reductions

Number of the retirement benefit reductions in Employees' Pension Funds



(Source : Rating and Investment Information, inc.)

1. Circumstances of corporate pension benefit reductions



(Source : Pension Fund Association.)

1. Circumstances of corporate pension benefit reductions

Assumed interest rate in supplementary pension of Employees' Pension Fund

(Unit : Number)

Year	2004	2005	2006	2007
~ 1 . 5 %	1	0	0	0
1 . 5 % ~ 2 . 0 %	4	2	2	2
2 . 0 % ~ 2 . 5 %	10	12	10	10
2 . 5 % ~ 3 . 0 %	19	21	23	22
3 . 0 % ~ 3 . 5 %	29	33	34	36
3 . 5 % ~ 4 . 0 %	58	58	55	62
4 . 0 % ~ 4 . 5 %	40	30	35	35
4 . 5 % ~ 5 . 0 %	42	43	47	46
5 . 0 % ~ 5 . 5 %	6	7	7	8
5 . 5 %	420	370	336	316
Average	4.86%	4.81%	4.77%	4.72%

(Source : Pension Fund Association.)

3. Examples of litigation over corporate pension benefit reductions

Reduction of benefits of beneficiaries of DB plan at N Group

- ✍ obtained the consent of at least two-thirds of qualified beneficiaries
- ✍ applied for approval with the Ministry of Health, Labor, and Welfare

This approval was denied

『deteriorated financial performance at the plan-sponsoring operating site renders a reduction of benefits unavoidable』

『without a benefit reduction, plan sponsor contributions will substantially increase, with prospects that sponsor-contributions cannot be paid by the plan sponsor, making a benefit reduction unavoidable』

N Group sued to have the ruling against its application for a change of its contract annulled.

This claim was turned down.

3. Examples of litigation over corporate pension benefit reductions

Reduction of benefits of beneficiaries of DB plan at N Group

	Content of the reduction of N Group pension beneficiaries
Before the reduction	Pension annuity rates of annually 7.0% or 4.5%, and interest until the annuity start date of annually 5.5% or 3.0%.
After the reduction	<p>Cash balance plan with adjustable pension annuity rate and interest until the annuity start date calculated on the basis of the 10-year JGB coupon rate.</p> <p>The floor of the adjustable rate is set at the minimum expected yield or 1.5% per annum, whichever is higher. The ceiling of the adjustable rate is set at 7.0%. Beginning with the month of implementation, a transitional measure is available such that the floor for the pension annuity rate is set at 3.5% for the duration of six years.</p>

4. Causal requirements for corporate pension benefit reductions

- M.H.L.W denied to approve a reduction of pension benefits of beneficiaries of N Group on the grounds that a “material deterioration in financial performance” was not present.
- At least two-thirds of qualified beneficiaries had consented to the reduction.
- In other words, for the qualified beneficiaries their criteria for consenting to a reduction was the question as to “how much of a reduction” (quality and extent) more than the reason.

4. Causal requirements for corporate pension benefit reductions

- The beneficiaries used criteria in their judgment entirely detached from whether a material deterioration in the financial performance was present.

- Under existing criteria the requirements for a reason for reduction are a current deterioration in financial performance and a future deterioration in cash availability.

- The time for a necessary review has arrived from the perspective of the continuance of corporate pension plans.

5. Criteria for judgment on corporate pension benefit reductions

The following tabulation shows stakeholders' interests and judgments directly and indirectly related to corporate pension plans.

	Plan sponsor	Employees	Beneficiaries	Regulators	Shareholders, etc.
Party related to the pension benefit reduction					×
Disadvantaged party	×			×	×
Company-internal party			×	×	×
Understands company valuation		×	×	×	
Understands the pension plan		×	×		×
Purpose / objective	Enhance enterprise value	Secure post retirement income	Secure post retirement income	Beneficiary protection	Obtain income
Significance of the pension plan	Cost	Labor compensation	Livelihood	-	Cost

5. Criteria for judgment on corporate pension benefit reductions

Viewed from stakeholders' respective positions

The plan sponsor

is the entity that implements the pension benefit reduction

understands the situation of the company

seeks to promote the company's continuance, growth, and enterprise value

understands the factors behind the implementation of a pension benefit reduction

consults with the pension actuaries when changes are made, and understands the effect

Employees

are parties related to the benefit reduction

do not have a correct understanding of the company's management situation

do not understand their corporate pension plan

criteria for judging the merits of a proposed reduction will vary depending on the employee.

5. Criteria for judgment on corporate pension benefit reductions

Beneficiaries

are parties related to the reduction

they do not belong to the organization, they are isolated

information from the company and among beneficiaries are insufficient

their only judgment criteria are the reason for the reduction and the reduction content indicated by the plan sponsor

Regulators

the institution that approves the reductions

It is believed that regulators validate the fairness of the reasons for a reduction from an objective standpoint

but their criteria are not known

they rely for information mainly on reports from management

Shareholders

are not directly related to a benefit reduction

may require that cost be reduced

5. Criteria for judgment on corporate pension benefit reductions

Management should inform those affected by the reduction (employees and beneficiaries) and regulators accurately and in good faith of the reason for the reduction and the reduction content.

Since the significance of a pension plan differs significantly from the perspective of employees and beneficiaries, respectively, **reason requirements and procedure requirements should be categorized.**

Given the need on the part of beneficiaries to avoid erroneous judgment and insufficient information, arrangements are necessary that emphasize **procedure requirements more than reason requirements.**

Since **regulators** are the institution that ultimately examines the content of a reduction, objective judgment criteria will become necessary.

6. Proposal for reduction criteria

Reduction criteria are discussed below. The following premises apply.

Q1. Are reasons for a benefit reduction necessary?

A. Not always.

Q2. What categories are available for classifying reason requirements as necessary and unnecessary?

A. The following perspectives are conceivable.

- **Lump sum retirement allowances due to retirement owing to personal reasons are treated as “deferred labor compensation.”**
- **Other elements (the differential between retirement benefits due to the employer reasons / normal retirement and due to personal reasons; life element.) are categorized as “compensation for services” without being treated as deferred labor compensation.**

6. Proposal for reduction criteria

Q3. Are reason requirements necessary other than currently existing?

A. The following reasons are conceivable.

- **Reduction related to interest risk**
- **Reduction related to a future deterioration in financial performance**
- **Reduction due to labor contract amendment, and others**

Q4. Is consent to the reduction necessary?

A. **Necessary, as currently practiced.**

Q5. What are the procedures for obtaining consent?

A. The following perspectives are conceivable.

- **Categories of procedures for employees (plan participants) and beneficiaries**
- **Higher requirements for the explanations by the plan sponsor concerning the reason for a reduction, etc.**

6. Proposal for reduction criteria

Establishment of separate categories for dealing with plan participants and qualified beneficiaries .

Benefit reductions affecting plan participants

(1) Deferred labor compensation (historical portion)

Performance of procedures for a reduction that as a reason requirement demands only a “(i) material deterioration in financial performance at the plan-implementing operating site.”

(2) Deferred labor compensation (future portion)

In addition to the reason requirement of Item (i), performance of procedures for reduction with “(ii) reduction due to future deterioration in financial performance” and “ (iii) reduction due to change in labor terms and conditions” as reason requirements.

6. Proposal for reduction criteria

(3) Amounts other than deferred labor compensation

Reason requirements are unnecessary but procedures for the benefit reduction should be performed. However, reason requirements are unnecessary only for the handling purposes under the regulator's procedures. The plan sponsor should still provide an accurate explanation to its employees of the reason indicated for the change to be implemented

(4) Amounts related to interest changes

In cases where a certain level of interest risk is exceeded, procedures for a reduction should be performed by providing employees with an explanation and obtain a written statement of consent. (Details are described later)

6. Proposal for reduction criteria

Reductions affecting qualified beneficiaries

(1) Amounts related to interest changes

In case of predetermined conditions of interest risk manifestation
Reductions are possible provided a predetermined benefit level is not breached.

Except that such reductions must be reverted to the benefit level before the reduction when the predetermined situation of interest risk manifestation is resolved.

< Example >

“Predetermined situation of interest risk manifestation” means, for example, that the present 5-year average JGB yield is less than 70 percent of the 5-year average JGB yield at the time the pension annuity rate was set.

“Predetermined benefit level” means, for example, a benefit level corresponding to a pension annuity rate of 70 percent of the present pension annuity rate.

6. Proposal for reduction criteria

(2) Amounts other than variable interest

Reduction procedures should be carried based on reason requirements “Material deterioration in financial performance at the plan-implementing operating site”

This concludes my presentation.

Thank you for your patience and attention.